Rates Scenario

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Rates Scenario for December 17, 2020

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Forecast Summary

	Actual	Forecasts									
	2020	2020	2021	2021				2022			
	Nov	Dec	Jan	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
BoC overnight	0.25	0.25[1]	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
10-yr Canadas	0.69	0.75	0.80	0.85	0.90	1.00	1.10	1.15	1.25	1.30	1.35
Fed funds	0.13	0.13[1]	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13
10-yr Treasuries	0.87	0.90	1.00	1.00	1.10	1.15	1.25	1.30	1.35	1.40	1.50
C$ per US$	1.31	1.28	1.28	1.28	1.27	1.26	1.25	1.25	1.25	1.25	1.25
US$/€	1.18	1.21	1.21	1.22	1.22	1.23	1.24	1.24	1.24	1.25	1.25
US$/£	1.32	1.34	1.34	1.35	1.36	1.37	1.39	1.39	1.39	1.40	1.40
MXN/US$	20.42	19.95	19.85	19.80	19.55	19.30	19.10	19.15	19.40	19.65	19.90
¥/US$	104	105	105	105	104	104	103	103	103	104	104

(policy rates are end of period; averages otherwise); [1] actual value
Sources: BMO Economics, Haver Analytics

Canada-U.S. Rates Outlook

- We look for both the Federal Reserve and Bank of Canada to remain steadfast as 2021 unfolds, maintaining policy biases to increase accommodation further if necessary, particularly during the first third of the year as surging COVID-19 cases and consequent increases in business and social restrictions weigh on economic surging COVID-19 cases and consequent increases in business and social restrictions weigh on economic growth before being remedied later in the year by the rollout of vaccines. The steadfastness is also reflected in being prepared to wait at least a couple of years before starting to tighten policy.

- On December 16, the **FOMC** repeated that it would maintain the 0%-to-0.25% fed funds target range *"until labor market conditions have reached levels consistent with the Committee's assessments of maximum employment and inflation has risen to 2 percent and is on track to moderately exceed 2 percent for some time."* But, it committed more concretely to *"continue to increase its holdings of Treasury securities by at least $80 billion per month and of agency mortgage-backed securities by at least $40 billion per month until substantial further progress has been made toward the Committee's maximum employment and price stability goals"*, compared to the prior looser commitment to purchasing *"over coming months… at least at the current pace"*. This more accommodative policy step was not as big as it could have been (e.g., increasing the pace and/or weighted-average-maturity of purchases), likely reflecting the FOMC's upgraded medium-term economic outlook (thank you, vaccines) and anticipation of more accommodative fiscal policy.
- In the **Summary of Economic Projections**, the 'dot plot' showed only 5 of 17 participants pencilling in a rate hike by the end of 2023, just one more than in September despite the upgraded medium-term economic outlook. For 2021-22, real GDP growth is 0.2 ppts higher with the jobless rate 0.4-to-0.5 ppts lower, and the CBO-defined output gap closes by 2022-end instead of after 2023. However, the top of the central tendency range of inflation projections only gets above 2.0% (to 2.1%) in 2023, far from the criterion to "*moderately exceed 2 percent for some time*".
- On December 9, the **Bank of Canada** repeated that it would "*hold the policy interest rate at the effective lower bound until economic slack is absorbed so that the 2 percent inflation target is sustainably achieved"*, which doesn't happen in its projection *"until into 2023"*. And, that it would *"continue its QE program [at least $4 billion per week] until the recovery is well underway"*, adjusting the program as required *"to help bring inflation back to target on a sustainable basis"*.
- Our working assumption is that **both central banks won't tighten until early 2024, with the net risks weighing on the side of sooner actions**. With policy rates remaining at their effective lower bounds at least until 2023, the front-end of the yield curve should remain restrained apart from what separate demand and supply pressures might materialize in bond markets, pressures that matter more for the back end of the curve. Big budget deficits are projected to persist on both sides of the Canada-U.S. border, keeping sovereign bond supply pressures on the boil. Meanwhile, investor risk appetites should be whetted as the rollout of vaccines brightens economic prospects and the attraction of riskier asset classes. Not helping this pending imbalance, beyond the next 12 months, we expect the Fed to start tapering purchases and to have stopped growing its balance sheet within the next 24 months. The BoC's timeline should be much sooner with its current purchase pace being larger than the Fed's relative to both GDP (even accounting for Fed MBS purchases) and, importantly, budget deficits.
- In the U.S., after a $3.1 trillion **budget deficit** in the fiscal year ended September 2020, the CBO projects a $1.8 trillion shortfall in fiscal 2021 and $1.3 trillion in 2022. However, these are before factoring in any near-term fiscal relief bill. The Fed's current purchase pace translates into an annualized $960 billion. In Canada, the deficit is estimated at $382 billion for the fiscal year ended March 2021, reflecting the most aggressive pandemic response among the world's largest economies. This is projected to drop to $121 billon in fiscal 2022 and $51 billion in 2023 but does not factor-in the shares of an additional $70-to-$100 billion three-year spending program. The BoC's current purchase pace translates into an annualized $208 billon.
- However, any prospective increases in **longer-term bond yields** should be well-checked by policy rates remaining 'low for long', and inflation pressures remaining well-contained by economic slack (at least for a couple of years) along with the secular forces of disinflation from technological change (a trend accelerated by the pandemic) and an aging population. For example, we look for 10-year Treasury yields to average around 1.25% by the end of 2021, with Canadas around 1.10%.
- After averaging record highs in April 2020, at the peak of pandemic panic, the **trade-weighted U.S. dollar index** has slipped about 9.0% reflecting several factors including improving investor-perceived global economic prospects and ebbing risks since the peak panic; U.S. policymakers being relatively aggressive on both the QE and budget deficit fronts; and, the pandemic hitting the U.S. relatively hard. The former factor, particularly, looks to weigh on the greenback further as the distribution of vaccines unfolds globally, weakening the unit another near-3% by the end of 2021. This should be the major force pushing the Canadian dollar firmer against the big dollar, despite Ottawa's world-leading fiscal thrust. It helps that oil prices are expected to drift modestly higher and the BoC is prone to taking away the QE punch bowl much faster than the Fed. Look for the **loonie** to average around C$1.25 (US$0.80) by the end of 2021.

Overseas

- We look forward to a year of economic recovery around the world, after global growth was shattered in 2020 by the coronavirus. The faster-than-expected rollout of vaccines was a game-changer, prompting some upward revisions to the medium-term outlook. However, with new lockdowns and extended restrictions in place over the holidays and into the new year, there is a **risk of another economic contraction in Europe** around the turn of the year. Economies have not fully recovered from the first wave and are still in a fragile state. Governments are blasting fiscal stimulus, which is appropriate as central banks can only do so much. This has been a year of a true joint effort between fiscal and monetary policymakers. Expect monetary policy to remain highly accommodative in 2021, with a risk of more QE to come. However, the major currencies will still strengthen, but on the back of a weaker U.S. dollar.

- The **ECB** gave financial markets the gift of a longer (by 9 months) and larger (by €500 bln) Pandemic Emergency Purchase Programme (PEPP) at its December meeting. President Lagarde also announced more cheap funding for banks, which will encourage them to keep credit flowing to the real economy. Meantime, the EU Recovery Fund was finally passed after being held up by Hungary and Poland. The fiscal support will benefit the hard-hit economies across Europe. However, the process is long and it will take time for the needed funds to flow directly to the governments and for the money to start being put to work. In the meantime, the ECB may be forced to extend the PEPP again if they judge that the crisis is not yet over.

- The **BoE** is not only trying to cushion the economy from the coronavirus hit, but it is also fielding the possibility of a hard Brexit. As of December 17, a mere two weeks before the end of the transition period, a deal has yet to be made although both sides are still talking (open communication is a good thing). Meantime, the central bank's key policy rate is already at a razor-thin 0.1%, and it raised the Asset Purchase Facility in November. What more can be done? Governor Bailey is not a fan of negative rates, but he admits that it is in the tool box. If push comes to shove—no trade deal—the Bank may be forced to resort to more easing come the spring.

- The Ministry of Finance has taken over in Japan as the **BoJ's** highly accommodative measures can only do so much. However, if the current wave takes a deeper toll on the economy, Governor Kuroda may be forced to ease further, perhaps not by pushing rates deeper into negative territory, but by increasing asset purchases. However, the over-arching view is that the Bank will stay-the-course, and let PM Suga and any new fiscal measures take over in supporting Japan's economy. Unlike other G7 economies, we see no meaningful change in JGB yields over the course of the next couple of years.

Foreign Exchange Forecasts

	Actual	Forecasts									
	2020	2020	2021	2021				2022			
	Nov	Dec	Jan	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Canadian Dollar											
C$ per US$	1.31	1.28	1.28	1.28	1.27	1.26	1.25	1.25	1.25	1.25	1.25
US$ per C$	0.765	0.781	0.783	0.784	0.789	0.794	0.798	0.800	0.800	0.800	0.800
Trade-weighted	117.4	118.7	118.8	118.9	119.2	119.5	119.8	119.9	119.9	120.0	120.0
U.S. Dollar											
Trade-weighted[1]	114.4	112.3	112.1	111.9	111.3	110.6	109.9	109.8	109.8	109.9	110.0
European Currencies											
Euro[2]	1.18	1.21	1.21	1.22	1.22	1.23	1.24	1.24	1.24	1.25	1.25
Danish Krone	6.29	6.15	6.15	6.15	6.10	6.05	6.00	6.00	6.00	6.00	5.95
Norwegian Krone	9.08	8.75	8.75	8.75	8.65	8.60	8.55	8.55	8.50	8.50	8.50
Swedish Krone	8.64	8.45	8.45	8.40	8.35	8.30	8.25	8.20	8.20	8.20	8.15
Swiss Franc	0.91	0.89	0.89	0.88	0.87	0.86	0.85	0.85	0.86	0.86	0.87
U.K. Pound[2]	1.32	1.34	1.34	1.35	1.36	1.37	1.39	1.39	1.39	1.40	1.40
Asian Currencies											
Chinese Yuan	6.60	6.52	6.51	6.50	6.47	6.44	6.41	6.38	6.36	6.33	6.31
Japanese Yen	104	105	105	105	104	104	103	103	103	104	104
Korean Won	1,115	1,090	1,085	1,085	1,075	1,065	1,060	1,055	1,050	1,045	1,040
Indian Rupee	74.2	73.7	73.6	73.4	73.0	72.6	72.1	71.7	71.2	70.7	70.2
Singapore Dollar	1.35	1.30	1.30	1.30	1.29	1.29	1.28	1.28	1.27	1.27	1.26
Taiwan Dollar	28.5	28.2	28.1	28.0	27.9	27.7	27.6	27.4	27.3	27.2	27.1
Other Currencies											
Australian Dollar[2]	0.728	0.750	0.753	0.755	0.763	0.770	0.778	0.780	0.780	0.780	0.780
New Zealand Dollar[2]	0.687	0.690	0.691	0.692	0.694	0.697	0.699	0.700	0.700	0.700	0.700
Mexican Peso	20.42	19.95	19.85	19.80	19.55	19.30	19.10	19.15	19.40	19.65	19.90
Brazilian Real	5.44	5.15	5.15	5.15	5.15	5.20	5.20	5.20	5.20	5.25	5.25
Russian Ruble	76.8	73.9	73.8	73.7	73.4	73.0	72.7	72.4	72.0	71.7	71.3
South African Rand	15.5	15.1	15.0	15.0	15.0	15.0	15.0	14.9	14.9	14.8	14.8
Cross Rates											
Versus Canadian Dollar											
Euro (C$/€)	1.55	1.55	1.55	1.55	1.55	1.55	1.55	1.55	1.56	1.56	1.56
U.K. Pound (C$/£)	1.73	1.72	1.72	1.72	1.72	1.73	1.74	1.74	1.74	1.75	1.75
Japanese Yen (¥/C$)	80	82	82	82	82	82	82	83	83	83	83
Australian Dollar (C$/A$)	0.95	0.96	0.96	0.96	0.97	0.97	0.97	0.98	0.98	0.98	0.98
Versus Euro											
U.K. Pound (£/€)	0.90	0.90	0.90	0.90	0.90	0.90	0.89	0.89	0.89	0.89	0.89
Japanese Yen (¥/€)	124	127	127	127	127	128	128	128	129	129	130

Local currency per U.S. Dollar (averages); [1] Federal Reserve Broad Index; [2] (US$ per local currency)

Sources: BMO Economics, Haver Analytics

Interest Rate Forecasts

	Actual	Forecasts									
	2020	2020	2021	2021				2022			
	Nov	Dec	Jan	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Cdn. Yield Curve											
Overnight	0.25	0.25[1]	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
3 month	0.11	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
6 month	0.14	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15
1 year	0.19	0.20	0.20	0.20	0.20	0.25	0.25	0.25	0.30	0.30	0.30
2 year	0.27	0.25	0.25	0.25	0.30	0.30	0.35	0.40	0.40	0.45	0.45
3 year	0.29	0.30	0.30	0.35	0.40	0.45	0.50	0.50	0.55	0.60	0.65
5 year	0.43	0.45	0.50	0.50	0.55	0.60	0.70	0.75	0.80	0.85	0.90
7 year	0.49	0.55	0.60	0.60	0.70	0.75	0.80	0.90	0.95	1.05	1.10
10 year	0.69	0.75	0.80	0.85	0.90	1.00	1.10	1.15	1.25	1.30	1.35
30 year	1.23	1.30	1.35	1.40	1.45	1.55	1.60	1.65	1.75	1.80	1.85
1m BA	0.47	0.45	0.45	0.45	0.45	0.45	0.40	0.40	0.40	0.40	0.40
3m BA	0.49	0.50	0.50	0.50	0.45	0.45	0.40	0.40	0.40	0.40	0.40
6m BA	0.67	0.65	0.65	0.60	0.55	0.55	0.50	0.45	0.45	0.45	0.45
12m BA	0.73	0.70	0.70	0.70	0.65	0.65	0.60	0.60	0.60	0.65	0.65
Prime Rate	2.45	2.45	2.45	2.45	2.45	2.45	2.45	2.45	2.45	2.45	2.45
U.S. Yield Curve											
Fed funds	0.13	0.13[1]	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13
3 month	0.09	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
6 month	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
1 year	0.12	0.10	0.10	0.10	0.10	0.15	0.15	0.15	0.20	0.20	0.25
2 year	0.17	0.15	0.15	0.15	0.20	0.20	0.25	0.30	0.35	0.35	0.40
3 year	0.22	0.20	0.20	0.25	0.30	0.35	0.40	0.45	0.50	0.55	0.60
5 year	0.39	0.40	0.40	0.45	0.50	0.55	0.65	0.70	0.75	0.80	0.90
7 year	0.63	0.65	0.70	0.75	0.80	0.85	0.90	1.00	1.05	1.10	1.20
10 year	0.87	0.90	1.00	1.00	1.10	1.15	1.25	1.30	1.35	1.40	1.50
30 year	1.62	1.65	1.75	1.75	1.80	1.85	1.90	1.95	2.00	2.05	2.10
1m LIBOR	0.14	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15
3m LIBOR	0.22	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
6m LIBOR	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
12m LIBOR	0.34	0.35	0.35	0.35	0.35	0.40	0.40	0.40	0.45	0.45	0.45
Prime Rate	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25
Other G7 Yields											
ECB Refi	0.00	0.00[1]	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
10yr Bund	-0.57	-0.55	-0.50	-0.45	-0.35	-0.25	-0.15	-0.05	0.00	0.05	0.15
BoE Repo	0.10	0.10[1]	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
10yr Gilt	0.32	0.35	0.40	0.45	0.55	0.60	0.70	0.80	0.85	0.90	1.00
BoJ O/N	-0.03	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
10yr JGB	0.02	-0.05	-0.05	-0.05	-0.05	-0.05	-0.05	-0.05	-0.05	-0.05	-0.05

Percent (policy and prime rates are end of period; averages otherwise); [1] actual value

Sources: BMO Economics, Haver Analytics

Disclosures

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